

December 5, 2003

Honorable Mayor and
Members of the City Council
City of Hazel Park
111 East Nine Mile Road
Hazel Park, MI 48030

Dear Mayor and Council Members:

We have recently completed our audit of the City of Hazel Park for the year ended June 30, 2003. In addition to the report on these statements, we offer the following comments and recommendations for your consideration.

OVERALL CITY FINANCIAL POSITION

As City Council and City management are aware, the City's overall financial position and economic health has continued to decline during the fiscal year ended June 30, 2003. With many of the City's primary revenue sources restricted or declining (e.g. Proposal A limit on property taxes, forecasted state shared revenue reductions, minimal or negative investment returns, and charges for services restrictions, etc.) while certain expenditures (e.g. employee healthcare, retirement benefits, etc.) continue to escalate with double digit percentage increases, the City continues to be in the midst of a serious financial challenge. The City's total Governmental Funds fund balance decreased from just under \$2,000,000 at June 30, 2002 to \$1,465,000 at June 30, 2003, of which almost \$745,000 is either not available or restricted in its use. The Municipal Ice Arena needed a contribution from the City's General Fund to break even for the year. While this contribution is significantly less than prior years, the arena continues to use general fund resources to continue operations. City management again needs to critically review its budgeted Fund balance positions and cash flow availability to evaluate the likelihood (based on facts known to date) of meeting initial budgeted targets established. This analysis should include a detailed assessment of the anticipated cash flow needs of the Municipal Ice Arena as well as a critical review of the primary revenue sources (e.g. taxes, state shared revenue, permit fees and court fines) and expenditures (e.g. labor costs including expected pension and healthcare obligations) including the level of citizen services planned versus what can be afforded. City management has indicated that this financial review is an ongoing and continuous process. A timely and thorough analysis of city finances for the next 6 months and following fiscal year is critical in identifying opportunities to improve revenues, reduce costs and create cash flow resources for the City to meet its financial obligations as they become due.

ACCOUNTING SYSTEM INTERNAL CONTROLS

The concept of "internal control structure" relates to the system of checks and balances intended to safeguard assets and ensure the reliability of the accounting data. The City's policies and procedures that have been put into place, the accounting system, and the environment that the City operates in all interact and together form the internal control structure.

ACCOUNTING SYSTEM INTERNAL CONTROLS (continued)

In planning and performing our audit of the financial statements of the City of Hazel Park as of June 30, 2003, we considered the City's internal control structure in order to determine the extent of our auditing procedures for the purpose of expressing an opinion on the financial statements and not to provide assurance on the system of internal control. However, consistent with our communications to the Mayor and Council in previous fiscal years, we once again noted certain matters involving the internal control and its operation that we consider to be reportable conditions under standards established by the American Institute of Certified Public Accountants. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control system that, in our judgment, could adversely affect the City's ability to record, process, summarize, and report financial data consistent with the assertions of management, in the financial statements.

This report contains items considered to be reportable conditions, as defined above, as well as other items we feel warrant your consideration.

General Checking Account Reconciliation

During the course of the past fiscal year, the general checking account of the City had not been reconciled on a timely basis. A timely, accurate reconciliation must be consistently performed of all significant cash and investment accounts of the City as part of a sound internal control system. In addition, the Finance Director is currently completing the bank reconciliations. The Finance Director should be reviewing the reconciliations prepared by another individual versus completing these reconciliations to enhance the segregation of duties. This should include maintaining a physical copy of the reconciliation and having the reviewer initial it indicating their approval.

A material weakness is a reportable condition in which, the design or operation of one or more of the internal control structure elements does not reduce to a relatively low level the risk that errors or irregularities in amounts that would be material in relation to the financial statements being audited, may occur, and not be detected within a timely period by employees in the normal course of performing their assigned functions.

Our consideration of the internal control system would not necessarily disclose all matters in the internal control system that might be reportable conditions and, accordingly, would not necessarily disclose all reportable conditions that are also considered to be a material weakness as defined above. However, we consider the lack of timely reconciliation procedures for the general checking account, and the lack of proper segregation of duties, to be a material weakness in the City's internal control system.

Employees' Retirement System

For the year ended June 30, 2003, we noted, as we have in previous years, that the Employees' Retirement System (ERS) investment activity had not been timely and adequately reconciled during the year. Because of the size of the ERS, the number of account managers and the volume of investment transactions that occur, it is imperative that an adequate level of internal control over the ERS record keeping and supervisory review functions be maintained. We recommend that the finance department analyze and record the ERS financial results on a monthly basis to ensure that all investment activity is properly accounted for and that the information provided by the trustees of the plan assets is properly reconciled to the ERS records maintained by the City.

CASH AND INVESTMENTS

While confirming cash balances with the financial institutions the City conducts business with, a confirmation was returned indicating two cash accounts under the City's name and tax identification number, which are currently not recorded in the City's financial system. These two accounts relate to a police program receiving private contributions during the year as well as some monies related to the Association of Retired City Employees. The total dollars involved is \$1,000 between the two accounts. The City should review the accounts and determine whether it is appropriate to have these accounts in the City's name, and if so, whether these accounts should be reflected in the City's financial records.

As mentioned in previous years, the City's investment policy states that a written report that summarizes investment activity, results, and holdings be annually submitted to the governing body (City Council) in accordance with Public Act 196 of 1997. City management should coordinate preparation, review and submission of these reports on a timely basis in order to comply with established policies and procedures. In addition, the City should also consider reviewing (at least annually) the established investment policy to determine if it is consistent with the City's current investment goals and needs.

DOWNTOWN DEVELOPMENT AUTHORITY

As mentioned in previous communications to the City Council, the City's Downtown Development Authority (DDA) has completed several projects which have enhanced and added value to the City. Due to the ongoing resources and investment commitment to this entity, the City should annually review the overall future plan of the district. This review must include an accurate projection of anticipated future expenditures including debt service commitments, estimated future revenue produced by existing tax captures, and analyzing other possible revenue sources that may be available to fund future projects. This review most likely requires the assistance of the City's attorneys to interpret the availability of other funds including captures within the DDA.

Keep in mind the DDA may only capture school related millages to the extent they qualified as eligible obligations in 1994. In addition, any excess captures that occur must be refunded to the proper taxing unit. The DDA currently has a liability recorded for certain excess captures and is currently reviewing them for accuracy.

ADMINISTRATIVE AND INTERFUND CHARGES

The General Fund continues to charge various Funds for administration and other services provided to these funds. We recommend that the City annually review the interfund charges to determine if these charges should be continued and, if so, that they are commensurate with the ongoing cost of administering these funds. In addition, although the charges appear reasonable, we recommend that formal documentation be maintained in support of these charges.

BUDGETING AND CASH FLOW REQUIREMENTS

As mentioned in several prior council letters and in consideration of the City's strained financial position and the current negative economic business climate, the City must develop a three-to-five year operating plan and financial forecast that would include alternative scenarios the City could expect to encounter. The following are examples of different situations that will arise:

- Expected changes in employee work force (contract expirations, renegotiations, attrition, etc.)
- The declining level of state shared revenue received

BUDGETING AND CASH FLOW REQUIREMENTS (continued)

- The expected levels of targeted capital and infrastructure expenditures including future debt service requirements
- The restricted growth of future property tax revenues
- Ability to provide future services consistent with today's level

In light of your recent municipal capital investments within the City, including future debt service commitments related to the road and infrastructure reconstruction programs and the construction and operations of a municipal ice arena complex, the development of an operating plan and cash flow forecast is imperative. By preparing plans under different scenarios, the City would be better equipped to respond to expected and unexpected short-term and long-term financial constraints.

WATER AND SEWER FUND MATTERS

Account Reconciliation

As mentioned in previous years, the Water and Sewer Fund customer receivables sub ledger should be reconciled to the general ledger on a monthly basis. Timely reconciliation of the customer receivables sub ledger is fundamental to a strong system of internal control and will allow for prompt resolution of identified billing, recording or collection issues. The Finance Director has communicated that this reconciliation is now being performed by his department at the writing of this letter.

Water Loss

We noted that the "water loss" calculation decreased substantially, which may be an indication of the City of Detroit using actual reads versus estimated reads of meters and installation of pressure reducing valves. Based on this analysis, the City of Hazel Park should determine if this conclusion is correct or if any monies may be due to the City of Detroit.

COMPENSATED ABSENCES

During the current year, the City tracked sick and vacation time for City employees using two different systems. The first system has the payroll coordinator manually tracking the time and updating a spreadsheet at the end of the year. The second system is tracked directly through the payroll system. To avoid any potential discrepancies between the systems, we suggest a reconciliation be performed on a regular basis or the use of only one system.

DELINQUENT PERSONAL PROPERTY TAXES

The City does not currently record delinquent personal property tax receivables on the general ledger or a related reserve for any amounts that would deem to be uncollectible. The City should consider recording these receivables in order to quantify potential dollars to be received by the City in future years.

COMPUTER SECURITY SYSTEM REVIEW

As governmental agencies implement technology and become increasingly reliant on the information produced by this cost saving tool, security is becoming paramount. We strongly believe the City should consider an independent security review of the information technology systems that support the operation of the City. An Information Technology Security Review would consider data, network and password security for all desktop workstations, as well as central servers. Further, the review would consider back-up and contingency and disaster recovery plans to ensure that the critical information contained at the City is sufficiently safeguarded. An independent review of the information technology environment would provide the City Council a tool by which to develop a plan for improvement opportunities and a means to enhance the security of information maintained on the public's behalf.

RETIREMENT SYSTEM

As you are aware, the City's contribution to the retirement system was not made prior to June 30, 2003. City Management had indicated they were awaiting the required contribution calculation to be recalculated by the actuary as a result in changes in assumptions which had not been communicated to the actuary prior to completion of the original actuary report. Management has indicated the full contribution has been made at the writing of this letter. The City should consider requesting from the actuary the required contributions are calculated one year in advance. This would give the City the ability to budget confidently the amount of required City contributions twelve months in advance of the contribution due date versus receiving the amount two months prior to the City's year end.

CHARGES FOR SERVICES

With many of the City's prime revenue sources limited due to enacted laws and/or State legislative control it is once again recommended that the City review its current rate structure utilized in charging for services, licenses, permits and other fees. Due to the annual increased costs associated with providing these services, we recommend that these charges be periodically reviewed for market and cost competitiveness. In determining the appropriateness of fees, both the direct costs associated with providing the service along with the amount charged by neighboring communities for similar services should be considered.

GOVERNMENT ACCOUNTING STANDARDS BOARD STATEMENT 34

As previously communicated to you, Governmental Accounting Standards Board (GASB) Statement 34 is now here! You will notice a different look to the audited financial statements this year. Although there are many differences with this new reporting model, the major additions are as follows:

- **Management Discussion and Analysis:** Management is now required to give an overview of the City's overall financial position and results of operations.
- **Government-wide Financial Statements:** The statements now adjust the traditional fund-based statements into a combined, full-accrual format. This allows a financial statement reader to see the City's financial position from a current and longer term perspective including its capital assets and long term debt.
- **Budget Comparison:** A financial statement reader will now be able to not only view the actual revenue and expenditures of the City as compared to the current budget, but also as compared to the original adopted budget.

GOVERNMENT ACCOUNTING STANDARDS BOARD STATEMENT 34 (continued)

The GASB believes that this new model will provide a more complete picture of the financial position of the City. We would be happy to schedule a time to provide a more detailed overview about this new reporting model so that you can obtain the greatest user benefit from it.

STATE SHARED REVENUE

The City will continue to feel the effects of the slow down in the State's economy. State shared revenue accounts for approximately 25% of the City's total General Fund revenue. Because of slower than anticipated growth in the State's sales tax collections (the sole source of revenue sharing payments to local units of government) and the State's current budget problems, which have resulted in additional appropriation reductions to the revenue sharing line item in the State's budget, revenue sharing payments for the State's fiscal years ending September 30, 2002, and 2003, were less than originally projected.

The previous Governor's original budget recommendation for fiscal year 2002/2003 was to keep total revenue sharing payments to cities, villages, townships, and counties constant (or frozen) at the fiscal year 2001/2002 level. This recommendation would have resulted in a reduction of approximately \$112 million from what the statutory formula would have otherwise allowed. As was well publicized following the introduction of the previous Governor's fiscal year 2002/2003 budget, there was an attempt in July 2002 to eliminate all statutory revenue sharing from the State's 2002/2003 budget. This attempt was not successful and was overridden via a veto by the Michigan Legislature. However, in December 2002, revenue sharing was cut another \$53 million by an Executive Order of the previous Governor.

The budget presented by the new Governor included an overall reduction to revenue sharing payments of 3 percent from the estimated payments for the State's fiscal year ending September 30, 2003. This version of the budget was ultimately adopted by the Michigan Legislature. While the State's budget has been approved for their 2003/2004 fiscal year, it included several very significant assumptions which have not been fully realized. The State Revenue Estimating Conference in October of 2003 addressed these shortfalls and the Governor is currently attempting to remedy the shortfall. Additionally, it is generally acknowledged that the State's budget woes will continue for several more years. As a result, we continue to urge the City to be conservative in its estimation of state shared revenue, as this line item in the State's budget remains vulnerable. We will continue to update the City as developments occur.

ELECTRONIC FUNDS TRANSFERS (ACH PAYMENTS)

Recently, Public Act 738 was passed, which allows local units of government to make and accept electronic funds transfers (ACH payments), if the local unit adopts a formal policy. While local units of government may have already been using the ACH system for payroll tax remittances and for the direct deposit of payroll, this new law requires a policy to be adopted.

Beginning immediately, a local unit's governing body may need to adopt a policy on ACH arrangements that includes all of the following:

- Designation of an individual as the party responsible for payment approval, accounting, reporting and compliance with the ACH policy;

ELECTRONIC FUNDS TRANSFERS (ACH PAYMENTS) (continued)

- A statement that this individual is required to submit documentation as follows:
 - describe the goods or services purchased,
 - the cost,
 - date of payment, and
 - the department benefiting from the purchase;
- A system of internal controls to monitor the use of ACH transactions; and
- The approval of ACH invoices before payment.

City management should discuss these requirements with legal counsel before formally adopting the City's policy.

CREDIT CARD POLICY

The City currently uses credit cards on a limited basis throughout the year although a formal credit card policy has not been adopted by the City council. We have provided City Management with a sample policy. The City Council, if it plans to continue use of credit cards, should adopt a policy regarding their use immediately.

PERSONAL PROPERTY TAX

As you are aware, the State Tax Commission approved, several years ago, new personal property tax tables for utilities. The new tables made drastic changes to the valuation of transmission and distribution property of utilities. General estimates are that use of the new utility tables result in approximately a 30% revenue loss on those properties. The City, like many other communities, has elected to continue to assess the transmission and distribution property of utilities using the old personal property tax tables. This issue was the subject of several lawsuits brought by various units of government against the State Tax Commission challenging the constitutionality of the new utility personal property tax tables. To date, the new utility personal property tax tables implemented by the State Tax Commission have been upheld. The State is currently in the process of determining how refunds will be made on appeals filed by the utilities pending the final resolution of this matter. We encourage the City to continue to monitor these developments as the City could be negatively impacted by the outcome.

TELECOMMUNICATIONS ISSUES

Local units of government had until May 9, 2003 to notify the State that they were "opting in" to the new Telecommunications Act. The City did opt in and did receive its first payment from the METRO Authority by July 2003 for approximately \$11,000. The first payment was for a partial year and at a prorated rate. The second and future payments should be much larger as they will be based on a full year and at the standard rate. Checks for the second payment will be distributed in the Spring of 2004. The City should continue to monitor its projected revenue based on the State's revenue level. The City is required to spend the money received in a manner consistent with the allowable costs under the grant. The City of Hazel Park has a reporting requirement regarding the use of these funds on an annual basis.

MUNICIPAL FINANCE ACT REVISIONS

The Municipal Finance Act was amended during 2001. Beginning after March 2002, communities are now required to submit a filing once a year with the Michigan Department of Treasury. This filing will serve as a pre-approval for the future debt issuances and is effective through the extended due date of the financial statement filings (i.e. 12/31/04 for a 06/30/03 year end since the 2003 audit is not due to the state until 12/31/03). The statement is due six months after the end of the City's 6/30 fiscal year end.

PROPERTY ASSESSMENT CAP

As you recall, Proposal A limits the growth in taxable value to the lesser of inflation or 5 percent. The inflation factor for this calculation is published by the State Tax Commission and in 2003 is at its lowest level in ten years as follows:

2003	1.5%	1998	2.7%
2002	3.2%	1997	2.8%
2001	3.2%	1996	2.8%
2000	1.9%	1995	2.6%
1999	1.6%	1994	3.0%

The 2003 inflation factor is being used for property taxes levied in the City's fiscal year ended June 30, 2004. Property taxes are the City's largest source of General Fund revenue. However, as indicated above, growth in existing property can be significantly limited due to Proposal A. This factor should be considered when the City is involved in any long-term financial planning.

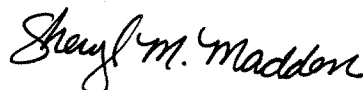
We would like to thank the Mayor and City Council for the opportunity to serve as auditors for the City. We would like to thank the City Manager, the Finance Director and the finance department staff for the cooperation, and assistance they provided during the audit. If you have any questions, or would like to discuss these items further, please feel free to contact us at your convenience.

Very truly yours,

PLANTE & MORAN, PLLC



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